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Subject: Section 217(b)(2) Civil Penalty Criteria

I am writing in response to the CPSC's Call for Comments on Civil Penalty Criteria under the Consumer Product Safety Improvement Act of 2008 (CPSIA). These comments are due on December 18, 2008.

General Remarks: We strongly urge the CPSC to reserve the imposition of penalties for only the most egregious and dangerous situations. Penalties under the CPSIA should NOT be to punish but instead to motivate better legal compliance. This is consistent with the mission of the CPSC - to protect the public. Notably, the CPSC does not have a mission to mete out "justice" so the use of penalties should be purposeful and not motivated by retribution. The CPSIA penalties can be used selectively to create compliance incentives when the facts demonstrate a need for such an incentive. We believe that the vast majority of safety incidents do not involve bad intentions or ill will so the need for "justice" will be infrequent. Penalties must be understood in light of the extremely high direct and indirect costs of any CPSC-imposed corrective action plan. Companies subject to corrective action plans incur tremendous costs in virtually all cases. Simple cases cost \$50,000 but most cases quickly pass \$100,000 in cost and skyrocket upward from there. The most notorious recalls in 2007 cost the affected companies tens of millions of dollars out of pocket - what would additional penalties accomplish? In addition, most companies experience commercial embarrassment and shame from these interactions, which must be seen as another form of high cost. The financial and other pain implicit in virtually any conflict with the CPSC typically accomplishes the mission of penalties - to modify behavior and ensure better future safety monitoring and legal compliance. In other cases (a factual inquiry), the CPSIA provides ample penalty firepower to up the ante and gain the cooperation of any recalcitrant company.

The complexity of the CPSIA is another factor which should be considered in penalty policy. In my experience, the CPSIA is too complex for most small and medium-sized companies to master - or even manage compliance with adequate resources. Perhaps the basics, the newspaper-worthy elements of the law, are clear but the rules are too sprawling and very specific. With so many rules to remember, properly implement and monitor across large product lines and evolving markets, and taking into account normal personnel ebb and flow affecting every company, the odds of complete compliance with this law is virtually nil at all times. Even Six Sigma companies (defined as organizations making 3.4 errors per 1,000,000 actions) will fail routinely to fully comply with the CPSIA if they are managing product lines of 500 items or more. At lower quality performance levels (even Five Sigma, 200 errors per 1,000,000 actions), regular full compliance will be impossible as a practical matter for virtually any product line over 25-50 products. [Typical competent companies are probably at Three Sigma or Four Sigma quality levels with experienced and knowledgeable personnel, and at lower levels after personnel turnover.] At the prevailing low value of most children's products, it is not possible for most (any?) children's product companies to invest the money in becoming Six Sigma companies - that's unrealistic on many levels. If this analysis is correct, good companies will now become serial violators of the law against their will and despite their constructive efforts and heavy compliance investments. It also implies that it will become much harder for the CPSC (or the public) to distinguish good companies from bad companies. We will all look "bad". If the complexity of the CPSIA essentially manufactures violations, the opportunity to penalize will rise exponentially - and if overused, will choke off

markets and harm good companies. This is another strong argument against use of penalties except where there is a demonstrated (factual) need to ensure compliance in the future.

We are fearful that the power to impose high penalties will be used coercively by the CPSC, ending any notions that law-abiding companies can work openly and in partnership with the CPSC. At present, the CPSC encourages a practice of "when in doubt, file". In a regulatory environment where minimum penalties are \$100,000, how many companies will take up the CPSC's suggestion to file "when in doubt"? Only the crazy ones. To be a truly effective safety agency, the CPSC cannot set penalty policies in a vacuum. If the CPSC sees value in having good (open and cooperative) relations with the business community, it may have to demonstrate restraint in the use of penalties. For the vast majority of companies subject to regulation, this approach will work very well. The CPSC has the legal authority to impose recalls without the consent of the offending companies, so there is already a power imbalance favoring the CPSC. If penalties are used inappropriately, we believe a moral hazard will be created - there will be a perverse incentive to hide safety violations (rather than disclose them) specifically out of fear of penalties. The CPSC cannot afford rules that discourage good and cooperative behavior.

Impact of Small and Medium-Sized Businesses: If imposed, penalties on the order of \$100,000 per violation will kill or severely damage many small and medium-sized companies. We do not see the purpose of such high penalties (as explained above). The best way to mitigate the impact of high penalties is not use them except in extreme situations. As noted, the cost to small and medium-sized companies of most corrective action plans is so high that behavior change will almost always follow. Penalties on small and medium-sized companies should be reserved for egregious conduct or a lack of appropriate cooperation. In these troublesome cases, where companies subject to a corrective action plan demonstrate an active disregard for the law or CPSC process, imposing a penalty to coerce better behavior might serve the interests of the public. We certainly believe penalties at the \$100,000 should be reserved for only the most shocking situations. At the levels specified in the CPSIA, penalties could be counter-productive with small and medium-sized companies, encouraging evasive and uncooperative behavior.

Penalty Factors Under Sec. 217(b)(2): We would like the CPSC to consider the interplay between (a) the nature of the product defect, (b) the occurrence or absence of injury, (c) empirical market data in the possession of the company. Companies must and do exercise business judgment in the daily administration of their affairs. We believe exercise of appropriate business judgment must be respected in any fair penalty scheme. This is an essentially factual inquiry using a "reasonable man" standard. Unfortunately, the listed factors might give the CPSC the opportunity to determine penalties using 20-20 hindsight ("you should have known . . ."). The problem with 20-20 hindsight is that it cannot be used prospectively - you have to know the unknowable. In light of the many "traps for the unwary" in the CPSIA, adding the impossible burden of satisfying 20-20 hindsight could drive more companies from the children's products market. As per my earlier comment letter, it is worth considering that one way to cure cancer is to kill the patient. I don't think we want to do that here.

There are cases where technical violations may occur (especially in a "when in doubt, file" situation) without the occurrence of any injuries. In this fact pattern, the absence of injury should be enough to justify no penalty - after all, the CPSC wants good companies to bring ambiguous issues to its attention early, so punishment for doing so should be very rare. In those cases, the economics of any corrective action plan must also be carefully weighed to not discourage further participation in the "when in doubt, file" program.

A more critical factor, in my view, is whether the company in question exercised good business judgment in its decision to sell or continue to sell the product. This would be a "reasonable man" standard and would take into account the need to exercise a duty of care toward consumers. Companies making consumer products must continually reassess what they know about their products and how they are being used in the field, and regularly remake the judgment that it is a

responsible act to continue to sell their products. This takes into account that facts as they emerge can change what a "reasonable man" might think about his product - a reasonable decision to sell a product on "day one" could change if information is received later that suggests the presence of latent defects. We do not think it will benefit consumers or the market to make penalty rules so strict that companies must become entirely risk-averse in what they do. That would be a terrible overreaction to past recalls.

The factor "number of defective products distributed" is not as relevant as the other criteria, unless it has a knowledge component (knowingly distributed). In the case of latent defects, that is defects which were hidden at the time of initial sale (reasonable man standard), the number of defective products distributed can be rather large before discovery of the defect. I do not see that this factor is relevant in the absence of knowledge (including appropriate diligence).

All in all, the CPSC must be very careful to not create a menu of "gotcha" penalties. The CPSC's penalty policy or rules will be part of the "game play" between the regulators and the regulated companies. If the rules encourage cooperation, the CPSC has a chance to partner with industry to improve safety. If industry believes that penalties are viewed as a revenue source or are being handed out in a way disproportionate to the infraction, then interplay between industry and the CPSC will change for the worse. If the penalties are too great, companies will exit the business (find something less regulated to do) or start hiding infractions as a survival technique. This outcome would not contribute to the safety of American children, and must be carefully considered in crafting the CPSC's penalty policies.

Other Factors to Consider When Setting Penalties: We believe that penalties, if appropriate, are best set in light of the factual situation of each particular case. We do not like the notion of a menu of penalties, in part because it seems to suggest a price tag for bad behavior (encouraging dangerous behavior when it is a profitable "bet" to risk the penalty). As the saying goes, the penalty should fit the "crime" so careful case-by-case factual analysis and consideration of the purpose of the penalty should be part of any penalty decision.

We believe the additional factors listed in your call for comments (past record of compliance, timeliness (and quality/completeness) of response, safety and compliance monitoring (and procedures), cooperation and good faith, economic gain from noncompliance, and product failure rate) are all appropriate factors. We consider record of compliance, cooperation and good faith to be critical mitigating factors.

We recommend that the CPSC also take note of the investment of the company in legal compliance and safety monitoring. Many companies will engage experienced counsel to advise them on appropriate safety and compliance practices. They may establish written procedures to govern their practices. Careful recordkeeping, general management involvement and awareness of the laws are other indicia of good citizenship. We believe economic gain from noncompliance is rare (but egregious), as bad behavior is a poor business strategy for the long term. Finally, we are suspicious of the value of failure rates as a factor. Failure rates can vary based on many factors, and high rates may not be evidence of egregious conduct - it could equally well be innocent. The implication is that a high failure rate necessarily reflects on character, which we think is not always true.

Thank you for considering our views on this important subject.

Sincerely,

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